

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201102027**

Release Date: 1/14/2011

Index Number: 613A.00-00, 613A.04-02

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:

, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:06
PLR-112227-10
Date:
September 17, 2010

LEGEND:

Taxpayer =

b =

c =

d =

Buyer =

City =

School District =

Location =

Dear :

This letter responds to your letter dated , requesting a ruling that Taxpayer's sale of b gasoline gallon equivalents (GGE) of compressed natural gas (CNG) to Buyer under a proposed take-or-pay contract and its sale of c GGE under a renewal take-or-pay contract are bulk sales under the bulk sale exception to the retailer exclusion rule in § 613A of the Internal Revenue Code. Additionally, Taxpayer requests a ruling that a similar sale of the same volume with the same terms and conditions to City and School District are bulk sales under the bulk sale exception to the retailer exclusion rule in § 613A.

Facts

The facts are represented by Taxpayer to be as follows:

Taxpayer uses a _____ accounting period, and method of accounting for maintaining its accounting books and records, and filing its federal income tax return.

Taxpayer is an independent energy company whose primary business operation is to explore for, develop and produce natural gas, crude oil and natural gas liquids. Taxpayer has neither retailer nor refiner operations as defined under § 613A.

Taxpayer does not make any retail sales of oil or natural gas, including CNG directly, or through a related person, or any product derived from oil or natural gas through any retail outlet operated by Taxpayer or a related person, or to any person (i) obligated under an agreement or contract with Taxpayer or a related person to use a trademark, trade name, or service mark or name owned by Taxpayer or a related person, in marketing or distributing oil or natural gas or any product derived from oil or natural gas, or (ii) given authority, pursuant to an agreement or contract with Taxpayer or a related person, to occupy any retail outlet owned, leased, or in any way controlled by Taxpayer or a related person.

Taxpayer is negotiating with commercial concerns to utilize CNG fueling stations, to be built and owned by Taxpayer, to refuel fleet vehicles. These commercial concerns own light, medium and heavy duty vehicles used for courier, trucking or delivery services, taxi services, waste management services, and for transporting employees to work sites.

Taxpayer proposes to sell to Buyer, under a d year take-or-pay contract, b GGE of CNG to be delivered to Taxpayer's facility in Location. Buyer has the option to contract for additional volumes in c GGE increments under the same conditions. The contract will renew automatically unless terminated by either party within 30 days of the renewal date.

The CNG fueling station will not be open to the general public. Only employees of Taxpayer and Buyer will have access to the station through a card system administered by Taxpayer. Taxpayer may offer to sell CNG to its employees for personal use, but Taxpayer will track those sales and treat them as retail sales for purposes of the small retailer exception, not to exceed \$5 million per year.

Taxpayer also is negotiating with City to build and operate a CNG fueling station for use by governmental transportation vehicles, and with School District to build and operate a CNG fueling station for use by School District's buses. The stations will not be open to the general public and no retail sales of CNG will be made from the stations.

Law and Analysis

Section 611 provides for a natural resource depletion deduction equal to the greater of cost or percentage depletion. The percentage depletion deduction for minerals generally is determined under § 613. Section 613A(a), however, provides that except as otherwise provided in § 613A, the allowance for depletion with respect to any oil and gas well is computed without regard to § 613.

Under § 613A(c), “independent producers and royalty owners” are allowed a deduction for percentage depletion with respect to limited quantities of domestic crude oil or natural gas production. However, § 613A(c) does not apply to any taxpayer that is a “retailer” or “refiner” as defined in § 613A(d)(2) and (d)(4).

Section 613A(d)(2) provides that a retailer is any taxpayer who (subject to a \$5 million de minimis sale rule):

Directly, or through a related person, sells oil or natural gas (excluding bulk sales of such items to commercial or industrial users), or any product derived from oil or natural gas (excluding bulk sales of aviation fuels to the Department of Defense)—

(A) through any retail outlet operated by the taxpayer or a related person, or

(B) to any person—

(i) obligated under an agreement or contract with the taxpayer or a related person to use a trademark, trade name, or service mark or name owned by such taxpayer or a related person, in marketing or distributing oil or natural gas or any product derived from oil or natural gas, or

(ii) given authority, pursuant to an agreement or contract with the taxpayer or a related person, to occupy any retail outlet owned, leased, or in any way controlled by the taxpayer or a related person.

The Tax Reform Act of 1976 (the 1976 Act) amended § 613A(d)(2) by adding the parenthetical bulk sales provision. The Senate Finance Committee report to the 1976 Act states that the retailer exclusion was amended to comply with the intent of Congress:

The retailer exclusion can be construed to apply in many cases where it was not intended to apply... The committee believes that the retailer exclusion was intended to apply only where the taxpayer has substantial retail operations and not to cases where a taxpayer's retail operations are essentially de minimis. In addition, the committee believes that the retailer exclusion should be applied only in the case of retail sales as that term is commonly used. Thus, bulk sales of oil or natural gas directly to industrial or commercial users should not be treated as retail sales through a retail outlet.

S. Rep. No. 94-938, 94th Cong., 2d Sess. 1, 425-426 (1976), 1976-3 C.B. (Vol. 3) 49, 463-464.

Section 1.613A-7(r)(1) of the Income Tax Regulations provides that for purposes of determining sales at a retail outlet, “bulk sales (i.e., sales in very large quantities) of oil or natural gas (but not bulk sales of any product derived from oil or natural gas) to commercial or industrial users shall be disregarded.”

Section 1.613A-7(r)(3) provides that the term “any product derived from oil or natural gas” means products that are recovered from petroleum refineries or extracted from natural gas in field facilities or natural gas processing plants. The term retail outlet means “any place where sales of oil or natural gas (excluding bulk sales of such items to commercial or industrial users), or a product of oil or natural gas (excluding bulk sales of aviation fuels to the Department of Defense), accounting for more than 5 percent of the gross receipts from all sales made at such place during the taxpayer’s taxable year, are systematically made for any purpose other than for resale.”

The preamble to regulations, T.D. 8348, 1991-1 C.B. 72, discusses that (i) the bulk sale exception applies only to oil and natural gas (including residue methane gas), (ii) the intent of the bulk sale exception is to exclude large volume sales to industrial or commercial users, and (iii) bulk sale means sales in “very large quantities” but not necessarily in excess of customary sale quantities. The preamble continues, “In response to a comment, the regulations have been revised to make it clear that bulk sales of oil or natural gas to industrial and commercial users are to be disregarded for purposes of determining a retail outlet. As revised, the regulations define bulk sales of oil or natural gas to mean sales of such items in very large quantities. It is not necessary that the quantity sold be in excess of the quantity customarily sold to be considered sold in bulk.” *See also, Witco Chemical Corp. v. United States*, 742 F.2d 615 (Fed. Cir. 1984) (the term retail sales was to be understood as the term is commonly used, sales in small quantities to ultimate consumers for personal use, not bulk sales to industrial and commercial users).

Based on the information submitted and the representations made, we conclude that Taxpayer’s proposed sales of CNG to Buyer and to City and School District meet the bulk sale exception requirements in § 613A.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion whether the transactions in this case otherwise meet the requirements of § 613A.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Brenda M. Stewart
Senior Counsel, Branch 6
(Passthroughs & Special Industries)
Office of Associate Chief Counsel